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In the Supreme Court of the United States

OCTOBER TERM, 1934

No. 537

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

INTER-MOUNTAIN LIFE INSURANCE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINION BELOW

The Board of Tax Appeals rendered no opinion. (See R. 19.) The opinion of the Circuit Court of Appeals (R. 25–26) is reported in 71 F. (2d) 962.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 25, 1934 (R. 26). By an order entered by a Justice of this Court on September 21, 1934, the time for filing a petition for a writ of certiorari was extended for a period of sixty days from September 25, 1934 (R. 27). The petition for

a writ of certiorari was filed November 22, 1934, and the writ was granted January 7, 1935 (R. 27). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether amounts held by respondent, a life insurance company, at the beginning and end of the calendar year 1922, to meet its liabilities to the holders of matured, unsurrendered, and unpaid coupons attached to certain of its life insurance policies constituted "reserve funds required by law" within the meaning of Section 245 (a) (2) of the Revenue Act of 1921.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in the Appendix, *infra*, pp. 43–46.

STATEMENT

The facts in the case were stipulated (R. 8–19), and may be summarized as follows:

Respondent is a capital stock life insurance company, organized in the year 1911 under the laws of the State of Utah, and during the year 1922 and prior thereto was engaged in the business of issuing life insurance contracts in Utah, Idaho, and Arizona (R. 8).

Among the policies of life insurance issued by respondent were certain policies denominated "20-Payment Life Coupon Policy—nonparticipating", each of said policies having nineteen coupons attached thereto, maturing serially on anniversary dates of the policy, beginning with the first and ending with the nineteenth, provided the premiums for the policy year beginning on the date of the coupon are paid and all premiums previously due have been paid (R. 8). The first coupon is not part of the first year's premium, which is solely for term insurance for the year (R. 11).

Each coupon is a promise that at its maturity, and upon the payment of the premium then due, respondent will pay the amount of the coupon to the owner (R. 8). A specimen copy of such coupon reads on its face (R. 14):

Coupon No. 1 $78.90

INTER-MOUNTAIN LIFE INSURANCE COMPANY
Salt Lake City, Utah
Will pay to the owner of this policy
at its home office
Seventy-eight dollars and 90 cents
Upon presentation of this coupon with
annual premium due
December 1, 1920
Provided all premiums previously due
have been paid
Policy No. *Sample.*

----------,
President.

The reverse side of the coupon reads (R. 14):

PAID-UP ADDITION FOR THIS COUPON
Two Hundred Twenty Dollars
Payable at death in addition to
the principal sum insured but
RECONVERTIBLE AT ANY TIME
into its cash value

By the terms of these coupon policies the insured is given certain elections, and options respecting such coupons, among which it is provided that respondent will credit to the insured the face amount of any matured coupon, as said coupon becomes due, and will pay compound interest thereon at the rate of 3½ per centum per annum, thereby creating a fund to the credit of the insured, which amount may be applied to the payment of premiums or withdrawn in cash at any time by the insured, and if not so applied or withdrawn by the insured prior to his death, the values represented by the coupons, with interest to date of death, will, in the event of the death of the insured while the policy is in force, be paid to the beneficiary, in addition to the face amount of the policy, upon surrender to the respondent of the policy and all coupons issued therewith and unpaid or unmatured prior to the date of said death (R. 8–9).

Pursuant to the terms of these coupon policies, the insured, at any time during the first policy year or within one month after the due date of the second annual premium, may, in writing, elect to convert the coupons originally attached to such policies, as such coupons mature, into paid-up life

additions to the policy for the amount shown on the reverse side of each coupon, and each coupon must then be surrendered to the respondent within one month after its due date, and payment of the annual premium due on the same date made in full in cash. When the coupon is so surrendered for paid-up additions to the policy and full premiums paid, respondent issues to insured a letter of acknowledgment of his remittance and coupon in which it is stated that the amount of the paid-up life insurance has been effected. The paid-up addition to the policy is then only reconvertible into its cash surrender value. (R. 9.)

During the calendar year 1922 respondent paid to holders of matured coupons surrendered during that year the face amounts of such coupons, together with accrued interest thereon in the sum of $897.58. The Commissioner of Internal Revenue, in auditing respondent's income-tax return for 1922, allowed as a deduction the amount of interest paid, i. e., $897.58, on coupons theretofore left to accumulate at interest and surrendered during the tax year 1922. (R. 10.)

Said coupon policies further contained the following (R. 11):

> GUARANTEED OPTIONS AT THE END OF TWENTY YEARS
>
> If all the premiums due hereon as stated in the consideration paragraph herein are paid to the company in full in cash, and if as each coupon attached hereto matures, the amount thereof has been left with the com-

pany to accumulate at interest, then upon the surrender of this policy and all coupons which are attached hereto at date of issue, the insured shall select one of the following options at the end of twenty years from the date hereof:

1. A guaranteed cash payment of eight thousand dollars.

2. A paid-up policy for life of fourteen thousand one hundred thirty dollars, subject to satisfactory evidence of insurability for the excess over the original face amount of this policy.

3. A guaranteed annual income of four hundred ninety dollars, to continue for at least twenty years and as many years thereafter as the insured shall survive.

4. A paid-up policy for life of ten thousand dollars, without medical reexamination, and an annual income of $174.40, payable annually thereafter during the life of the insured.

And the following (R. 12):

Fully paid-up benefit: If all of the values represented by the first fourteen coupons attached to this policy at issue, are left on deposit with the company at compound interest as aforesaid, the company will, upon written request of the insured hereunder, issue in lieu of this policy a fully paid-up policy for ten thousand dollars ($10,000) at the end of fifteen years from the date of this policy, upon the surrender to the company of this policy and all of the coupons originally attached hereto.

On January 1, 1922, the amount of respondent's liability to the holders of *matured, unsurrendered,* and *unpaid coupons,* which had been left with respondent to accumulate at interest (in accordance with one of the options contained in the policies so to do), with accrued compound interest thereon, amounted to the sum of $126,949.03, and at December 31, 1922, to the sum of $146,097.75. The mean of these sums is $136,523.39, and this sum the Commissioner of Internal Revenue refused to include in respondent's "reserve funds required by law" for the year 1922. (R. 9.)

The Board of Tax Appeals sustained the contention of the respondent that the amounts held to meet its liabilities to the holders of matured, unsurrendered, and unpaid coupons constituted "reserve funds required by law" within the meaning of the Revenue Act, and the Circuit Court of Appeals denied the Commissioner's petition for review.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that a liability which may be converted into life insurance at the option of the insured, but which has not been so converted during the tax year, is one against which a technical insurance reserve, such as is contemplated by Section 245 (a) (2) of the Revenue Act of 1921, may be set up and maintained.

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2. In holding that amounts which had become unconditionally due and payable during the year 1922 to the holders of matured, unsurrendered, and unpaid coupons, and which had been left during said year with respondent to accumulate at interest, and accrued interest thereon, constituted "reserve funds required by law" within the meaning of Section 245 (a) (2) of the Revenue Act of 1921.

3. In holding that the "legal reserves" required to be maintained by respondent during the year 1922 under the laws of the State of Utah included the amounts, with accrued interest thereon, held by respondent to meet its liabilities during said year to the holders of matured, unsurrendered, and unpaid coupons.

4. In affirming the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

The case deals solely with coupons attached to life insurance policies, which had become unconditionally due and payable simultaneously upon the payment of an annual premium by the insured, and which, after their maturity, had been left with the company to accumulate at interest, thereby creating a fund which might be applied to the payment of premiums or withdrawn in cash at any time by the insured. We contend that the Board of Tax Appeals and the Circuit Court of Appeals were in error in holding that the amount of such matured coupons and interest constituted a part of the "reserve funds

required by law" within the meaning of Section 245 (a) (2) of the Revenue Act of 1921.

A consideration of the decisions of this Court in *McCoach* v. *Insurance Co. of N. Amer.*, 244 U. S. 585, *United States* v. *Boston Insurance Co.*, 269 U. S. 197, and *New York Ins. Co.* v. *Edwards*, 271 U. S. 109, shows that the legal reserve for life insurance companies intended by Congress has a special technical meaning, contemplating a fund actuarily computed to meet unmatured life risks on existing policies; that it does not include funds held to satisfy accrued liabilities due to individual policyholders, even though such a fund may be required by State law for solvency purposes. The changes made by Congress in the Revenue Act of 1921 in the method of computation of the gross income and deductions of life insurance companies evidence no purpose to give the term "reserve funds required by law" a new meaning.

The amounts here in controversy are not embraced within the legal reserves forming the basis of the deduction afforded by Section 245 (a) (2) of the Revenue Act of 1921. The matured unpaid coupons involved had not been used to pay insurance premiums or to purchase paid-up additions to the policy. During the taxable year involved they represented an accrued liability of the respondent and a present indebtedness to the individual policyholder, thus differing clearly from the insurance "reserve" held for

the group, which does not become an indebtedness to the individual until the policy matures. The fact that certain options were afforded by which the policyholder might use the coupons and interest in the future to purchase additional insurance benefits does not convert the funds held against the coupon liability into a legal reserve in the taxable year when the options had not been exercised. The legal reserve provides for insurance risks already undertaken and cannot be extended to include insurance which may or may not be purchased in the future. Furthermore, even if these options are exercised, the cash accumulations to the credit of the individual policyholder upon the coupons are sufficient to compensate the company for any additional risk undertaken. Until the policyholder has exercised his option the amount held against matured coupons represents a pure accrued liability, not the subject of the legal reserve. This reserve is computed with reference to a large number of policyholders as a group and cannot include an account of the company with an individual policyholder in which the group does not share.

The adverse decisions of the courts and the Board of Tax Appeals are based upon misconceptions of the character of the reserve required by law and its relation to the amount in issue. The decision of the Court of Claims in *Continental Assur. Co.* v. *United States,* 8 F. Supp. 474, represents the correct view.

ARGUMENT

The instant case deals solely with matured, unsurrendered, and unpaid coupons which by their maturity and the payment of the required premiums on the policies to which they were attached had become unconditionally due and payable on demand by their respective holders. The so-called coupons are not coupons in the sense in which that term is ordinarily used, that is, as representing interest due or to become due on a principal obligation. Instead, each represents a principal amount, paid in as part of the premium required and paid on the due date of the coupon, and immediately due and payable on demand, simultaneously with the payment of the money. They are in effect receipts for money deposited—demand obligations. The amounts represented had been left by the holders with the company to accumulate at compound interest at the rate of 3½%, thereby creating a fund which might be applied to the payment of premiums or withdrawn in cash at any time by the insured (R. 12). The insured was also afforded certain other options with respect to these coupons (R. 11–12), none of which had been exercised or could have been exercised during the taxable year involved. Until one of these options was exercised the money represented by the coupons remained with the company, payable on demand to the insured.

The amounts of the matured coupons thus left to accumulate, and interest thereon, aggregated

$126,949.03 at the beginning, and $146,097.75 at the end of the taxable year. The mean of these two amounts is the sum which the Board of Tax Appeals and the Circuit Court of Appeals held constituted part of the "reserve funds required by law", within the meaning of Section 245 (a) (2) of the Revenue Act of 1921, *infra*, p. 43.[1] We contend that the sum was during the taxable year a matured liability which should not be so included. The position of the court below is in accordance with its own decision in *Commissioner* v. *Great American Life Ins. Co.*, 70 F. (2d) 133, and with the decisions in *Commissioner* v. *Standard Life Ins. Co. of America*, 47 F. (2d) 218 (C. C. A. 3d), and *Commissioner* v. *Western Union Life Ins. Co.*, 61 F. (2d) 207 (C. C. A. 9th). The Board of Tax Appeals has consistently held to the same effect. See *Standard Life Ins. Co. of America* v. *Commissioner*, 13 B. T. A. 13; *Reserve Loan Life Insurance Co.* v. *Commissioner*, 18 B. T. A. 359; *Farmers Life Insurance Co.* v. *Commissioner*, 27 B. T. A. 423; *Missouri State Life Insurance Co.* v. *Commissioner*, 29 B. T. A. 401; *Atlas Life Insurance Co.* v. *Commissioner*, 29 B. T. A. 750. The position of

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[1] A 4% deduction of the mean of the reserve funds was originally diminished by the amount of tax-exempt interest received (R. 5). Subsequently, and following this Court's decision in *Nat'l Life Ins. Co.* v. *United States*, 277 U. S. 508, it was stipulated before the Board of Tax Appeals that the net income should be reduced by the amount of such tax-exempt interest (R. 9–10).

the Government has been sustained in a recent decision of the Court of Claims in *Continental Assur. Co.* v. *United States,* 8 F. Supp. 474, where that court, in an exhaustive opinion, held that the reserve required by law does not include amounts held to meet the obligations on matured unsurrendered coupons.

I

THE TERM "RESERVE FUNDS REQUIRED BY LAW" TO BE MAINTAINED BY A LIFE INSURANCE COMPANY WITHIN THE MEANING OF SECTION 245 (A) (2) OF THE REVENUE ACT OF 1921 AND CORRESPONDING PROVISIONS OF PRIOR REVENUE ACTS, MEANS THAT FUND WHICH, WITH ACCRETIONS FROM INTEREST, IS HELD "RESERVED" TO MATURE OR LIQUIDATE, EITHER BY PAYMENT OR REINSURANCE WITH OTHER COMPANIES, FUTURE UNACCRUED AND CONTINGENT CLAIMS ON EXISTING OBLIGATIONS OF LIFE INSURANCE IN FORCE AND UNMATURED. IT DOES NOT INCLUDE AMOUNTS HELD TO SATISFY ACCRUED LIABILITIES

Under the Revenue Acts prior to the Revenue Act of 1921 insurance companies were entitled to deduct the net addition to reserve funds required by law.[2] The Revenue Act of 1921 inaugurated a new method of taxation with respect to life insurance companies and permitted a deduction of 4% of the mean of the reserve funds required by law and held at the beginning and end of the taxable year. The term "reserve funds required by law" was not defined in any of the various Acts, but the

[2] Act of August 5, 1909, c. 6, 36 Stat. 11, 112, Sec. 38; Act of October 3, 1913, c. 16, 38 Stat. 114, 166, 172, Sec. II G. (b); Revenue Act of 1916, c. 463, 39 Stat. 756, 767–768, Sec. 12 (a) Second; Revenue Act of 1918, c. 18, 40 Stat. 1057, 1077–1079, Sec. 234 (a) (10).

decisions of this Court on the subject show that it has a special technical and peculiar meaning in the law of insurance, and does not include the amounts in controversy here.

The first case to reach this Court on the subject was *McCoach* v. *Insurance Co. of N. Amer.*, 244 U. S. 585, involving a deduction claimed for reserves on account of incurred but unpaid policy loss claims of a fire insurance company. The respondent had been required by administrative practice in Pennsylvania to hold assets against such liabilities. In denying the deduction this Court said (p. 589):

> The object is to exercise abundant caution to maintain the companies in a secure financial position.
>
> The act of Congress, on the other hand, deals with reserves not particularly in their bearing upon the solvency of the company, but as they aid in determining what part of the gross income ought to be treated as net income for purposes of taxation. There is a specific provision for deducting "all losses actually sustained within the year and not compensated by insurance or otherwise." And this is a sufficient indication that losses in immediate contemplation, but not as yet actually sustained, were not intended to be treated as part of the reserve funds; that term rather having reference to the funds ordinarily held as against the contingent liability on outstanding policies.

In the foregoing language this Court clearly indicated that *all* reserves required by law were not intended by Congress as deductions; that "the reserve" allowed represents funds held on account of insurance in force and unmatured during the taxable year, as distinguished from those held to meet matured policy obligations. In the *McCoach* case losses actually sustained and paid were allowed under another specific provision of the Act, and this Court held that losses in immediate contemplation but not yet actually paid were not deductible as a part of the legal reserve. In the instant case the only loss actually sustained is represented by interest actually paid, the deduction of which is permitted by Section 245 (a) (8) of the Revenue Act of 1921 (*infra,* p. 43), and has been allowed by the Commissioner (R. 9). At the moment of payment of the premium the obligation of repayment evidenced by the coupon accrued, becoming, in analogy to the *McCoach* case, a loss in immediate contemplation, not yet paid and not deductible as a legal reserve.

The basic requirements of the reserves required by law announced in the *McCoach* case have not been changed in subsequent decisions of this Court. In *Maryland Casualty Co.* v. *United States,* 251 U. S. 342, the Court apparently departed somewhat from the rule of the *McCoach* case and allowed certain sums to be added to reserves on the strength of the requirement of the

State Insurance Department, although they represented accrued claims. Even in that case, however, this Court said (p. 350):

> The term "reserve" or "reserves" has a special meaning in the law of insurance. While its scope varies under different laws, in general it means a sum of money, variously computed or estimated, which with accretions from interest, is set aside, "reserved," as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims, *and claims accrued, but contingent and indefinite as to amount or time of payment.* (Italics supplied.)

While the italicized portion of this quotation would seem to indicate that accrued claims were to be allowed as a reserve deduction, the next decision of the Court in *United States* v. *Boston Insurance Co.*, 269 U. S. 197, expressly disapproved this departure and reaffirmed the principles of the *McCoach* case. This Court said in part (p. 202):

> It follows from *McCoach* v. *Insurance Co.* that the permitted deductions specified by § 12, Act 1916, do not necessarily include anything which may be denominated "reserve fund" by state statute or officer. We there distinctly ruled that the "reserve fund" of the Federal Act did not include something held by a fire and marine insurance company to cover accrued but unsettled claims for losses. We adhere to and reaffirm that doctrine. How far it must be

> modified, if at all, in respect of insurance companies which issue casualty, surety or liability policies or similar obligations is not now before us.

Referring to the decision in the *Maryland Casualty Co.* case, *supra*, this Court said (p. 203):

> Upon a reexamination of the record it becomes plain that we misapprehended the opinion and ruling of the lower court; also that the reason advanced to support our conclusion is insufficient. * * *. The finding that the Insurance Department of Pennsylvania, pursuant to statute, had at all times since and including 1909 required claimant to keep on hand, as a condition of doing business in the State, "assets as reserves sufficient to cover outstanding losses," without more, was not sufficient to justify the deduction of the reserve as one required by law to be maintained, within the meaning of the Act of Congress. This had been announced by *McCoach* v. *Insurance Co.*

The meaning of the term was next discussed by this Court in *New York Ins. Co.* v. *Edwards*, 271 U. S. 109. There the Superintendent of Insurance of the State of New York required the company to set aside a special fund to meet unreported death losses for amounts due policyholders who had died during the calendar year, and to carry a fund to meet liabilities for the payment of annuities to former soliciting agents as provided by their contracts of employment. The company claimed

the deduction of both of these amounts as net additions to reserve funds required by law. In denying the claim the Court said (pp. 119, 120):

> We think this claim was properly rejected by the Commissioner, although the courts below held otherwise. *McCoach* v. *Insurance Co. of North America,* 244 U. S. 585, and *United States* v. *Boston Insurance Co.,* 269 U. S. 197, pointed out that "the net addition, if any, required by law to be made within the year to reserve funds," does not necessarily include whatever a state official may so designate; that "reserve funds" has a technical meaning. It is unnecessary now to amplify what was there said. The item under consideration represented a liability and not something reserved from premiums to meet policy obligations at maturity.
>
> * * * * *
>
> As pointed out above, the term "reserve funds," in the taxing Act, has a technical meaning. The compensation which an insurance company agrees to pay soliciting agents has no relation to the reserve held to meet maturing policies; and when it sets aside a fund to provide payments to such agents this cannot be regarded as a reserve within intendment of the statute.

In each of the foregoing cases the taxpayer contended that accrued liabilities constituted "reserves" within the meaning of the Federal statutes. In each case the contention was denied, save only in the *Maryland Casualty Co.* case, *supra,*

which in effect was later disapproved upon the ground that the claims were no longer unaccrued and contingent. So while the company in the *New York Ins. Co.* case was required by the laws of the State of New York to hold "reserves" for future unaccrued and contingent death claims, the so-called "reserves" which the company was required to maintain for accrued but unreported death claims were not "the reserves" required by law within the meaning of the Federal statutes.

The foregoing cases were decided under Acts prior to the Revenue Act of 1921. While Congress adopted a new plan for the taxation of life insurance companies in the latter Act, there is no indication of a purpose to give the term "reserve funds required by law" a new meaning. Under prior Acts the gross income of life insurance companies included their premium receipts and they were permitted to deduct the amounts paid on policies (except as dividends), and amounts required by law to be added to their legal reserves. The inclusion of premium receipts with corresponding deductions was found to be unsatisfactory, and in the Revenue Act of 1921, with the approval of at least most of the life insurance companies, Congress substituted a new basis for computing the tax. See dissenting opinion of Mr. Justice Brandeis in *Nat'l Life Ins. Co.* v. *United States,* 277 U. S. 508, 522–523. It was provided that the gross income should consist of investment income, that is, income from "inter-

ests, dividends, and rents" (Sec. 244 (a), Revenue Act of 1921), and in order to ascertain the net taxable income nine classes of deductions were allowed, one of which is that here in issue, permitted by Section 245 (a) (2), *infra*, p. 43.

Since underwriting income (premium receipts) was not included in gross income, the deduction of the mortality content in the "net or mathematical premium" could no longer be permitted; accordingly the deduction of the net addition to reserves required by law was eliminated. There still remained for consideration, however, the interest content in the "net or mathematical premium", since it was clear that a portion of the interest, dividends and rents received by a life insurance company must be used each year in maintaining the legal reserve, that is, in adding to it on the basis of a certain interest rate, varying from 3% to 4%, according to the requirements of the statutes of the several States. Since gross income included all interest, dividends and rents received, it was proper to permit the deduction of that portion thereof included in the gross income which was required to mature the policy as a life risk, namely, the interest element. Accordingly Congress provided for the deduction of 4 per centum of the mean of the reserve (the highest percent required to be credited thereto by any of the State laws), and based the deduction upon the mean of the reserves held at the beginning and end of the taxable year.

The deduction allowed by Section 245 (a) (2) of the Revenue Act of 1921 was perfectly consistent with that permitted by prior Acts, to wit, the net addition to reserves required by law, and under the new Act no different meaning is to be attributed to the term "reserve funds." See *Massachusetts Mut. Life Ins. Co.* v. *United States,* 56 F. (2d) 897 (C. Cls.); *Standard Life Insurance Co. of America* v. *Commissioner,* 13 B. T. A. 13, 27. We submit that the term as it is used in the Revenue Act of 1921 does not embrace everything required as a reserve by State statute or State official; that its special meaning for life insurance purposes contemplates a fund actuarily computed, set aside from premiums, and built up with accretions from interest to meet unmatured life risks upon existing policies; and that it does not include funds held to satisfy matured accrued liabilities due to individual policyholders. Any such fund, although it may be required by State law, is merely a solvency reserve, and not the special technical reserve peculiar to insurance contracts contemplated by the Act. The reserve required by law is not a present liability. *Duffy* v. *Mutual Benefit Co.,* 272 U. S. 613. The special meaning of the legal reserve excludes amounts held on account of matured obligations and also those held by insurance companies which do not represent insurance in existence and in force during the taxable year. In the one case the reserve has already served its purpose and the amounts

held have become accrued liabilities, unconditionally due and payable; in the other, since there is no insurance as yet in existence, there can be no reserve of the character contemplated by the Act.

II

THE AMOUNT IN CONTROVERSY IN THE PRESENT CASE IS NOT ALLOWABLE AS A DEDUCTION UNDER SECTION 245 (a) (2) OF THE REVENUE ACT OF 1921

It is conceded that assets equal to the amounts in issue were required by the State law to be held by the company. Under the Utah statute (Revised Statutes, 1933, Title 43, c. 3, Sec. 4, *infra*, p. 45), the respondent was required to maintain assets equal to or exceeding all of its "outstanding liabilities", including "legal reserves", as provided in Section 12 of Title 43, c. 3, of the Utah Revised Statutes, *infra* p. 46. Consequently the respondent was required to have on hand not only the legal reserves peculiar to life insurance contracts calculated upon the basis of the American Experience Table of Mortality, with interest at 3½% per annum, but in addition thereto, assets in an amount equal to all of its outstanding liabilities, including the amount of the matured unpaid coupons here in issue, together with accrued interest thereon. The question, however, is not whether respondent was required under the law of the State to maintain assets equal to all of its liabilities, but whether the amount here involved constituted a legal reserve within the meaning of the Federal statute. We contend that it did not.

The correct answer to the question would seem to depend upon whether the coupons in this case involved life insurance during the taxable year. If they did not, then there is no insurance liability with respect to these coupons against which the insurance reserve is required to be maintained. It is not disputed that the amounts in controversy are represented by unpaid matured coupons which have been left with the company to accumulate at interest (R. 9). They had not been used to pay insurance premiums. If they had been so used this case would not be here. Also they had not been used, nor could they be used, to purchase paid-up life additions to the policy (R. 9, 14), since the terms of the policy provide that the election must have been made within one month after the due date of the second annual premium (R. 14); in any event, any such coupon so used must have been surrendered to the company within one month of its due date (R. 14), and such coupon would not be here in issue. Since none of the options mentioned had been exercised, the matured coupons, together with interest, constituted by the express terms of the policy a fund to the credit of the policyholder which might be withdrawn in cash at any time (R. 9, 12), or which, if not withdrawn, upon the death of the insured would be payable to th beneficiary in cash in addition to the face amount of the policy (R. 9). Upon default in payment of premiums the amount was payable to the

insured in addition to the rights granted with respect to his insurance (R. 14).

The coupons thus represented, during the year 1922, a pure liability of the respondent. The policyholder's election to leave them with the company at the time they became due and payable does not change their character as liabilities of the company, inasmuch as they are subject to his right to demand payment at any time. They evidence a pure debtor and creditor relationship. They are as much a direct liability to the policyholder as a deposit in a bank. They represent a present indebtedness to the *individual* policyholder, and thus differ clearly from the insurance "reserve" held for the group, which does not become an indebtedness to the individual until the policy matures. *Duffy* v. *Mutual Benefit Co.*, 272 U. S. 613, 618–619.

The fact that certain options were afforded by which the policyholder might in the future use his accrued matured coupons and interest as cash for the purchase of additional insurance benefits does not serve to convert the funds held to meet the accrued coupon obligations into an insurance reserve for the year 1922 when the options had not been exercised. One of these options permits the amount of each of the nineteen coupons as it matures to be left with the company to accumulate at interest and to be surrendered together with the policy at the end of twenty years, in which event the policyholder may elect to receive one of the

following: (1) A cash payment of $8,000; (2) a paid-up policy for life of $14,130, subject to satisfactory evidence of insurability for the excess over the original face amount of the policy; (3) a guaranteed annual income of $490 for at least 20 years; (4) a paid-up policy for life of $10,000, without medical re-examination, and an annuity of $174.40 (R. 11). The remaining option provides that if all of the values represented by the first fourteen coupons are left on deposit with the company at interest, the company will, upon written request of the insured, issue a full paid-up policy for $10,000 at the end of 15 years upon surrender of the policy and all of the coupons originally attached (R. 12).

None of the above options was exercised, nor could any have been exercised, during the year 1922 to convert the matured unpaid coupons then payable on demand into amounts then held at life risk, that is, into life insurance. The respondent was not organized until 1911 and accordingly none of the above options to convert accrued liability into an insurance risk could have been exercised until 1926, fifteen years later.

Moreover, whether or not the conversion could have taken place in the year 1922, the fact remains that it had not occurred and no insurance liability existed upon the respondent's part save the obligation to pay the face amount of the policy, the reserves for which are not in dispute in this case.

The fact that the coupons might be used in the future to acquire additional insurance benefits is immaterial. The Revenue Acts generally are concerned with certainties, not conjectures. So in *Brown* v. *Helvering,* 291 U. S. 193, the taxpayer was not allowed to set up a reserve to meet cancellations which might reasonably be expected to occur in the future. Here a reserve allowed to provide for insurance risks already undertaken may not be extended to include insurance which may or may not be purchased in the future. It would be just as logical to permit the respondent to establish, as part of its legal reserve, funds set aside in anticipation of a possibility that some or all of its policyholders might later pay in additional amounts, either to increase the amount of their insurance or to shorten the premium-paying period. The income of the company for the year 1922 must be taxable then or not at all. It cannot be reduced by a deduction given for a specific purpose when the purpose itself is absent and may never come into existence.

Furthermore, none of the possibilities presented in the options referred to will increase the insurance risk beyond the face amount of the policy or principal amount insured until actually exercised, in which event the cash accumulations to the credit of the individual policyholder are sufficient to compensate the company for any additional risk undertaken. For example, where the policyholder allows his coupons to mature and remain at inter-

est until all premiums are paid, he may, if then insurable, receive a paid-up policy for the sum of $14,130. This amount exactly equals the face value of the policy plus the amount of insurance which may be purchased at age 55 by a net single premium of $2,340, the face value of the matured coupons with interest at the end of 20 years.[3] Similarly, the sum of $8,000 payable in cash at the end of 20 years upon surrender of the policy and the coupons equals $5,660, the cash or loan value of the policy at that time (R. 15), plus the value of the coupons with interest.

A similar situation obtains with respect to the right of the policyholder at the end of the fifteenth policy year to surrender his policy and all coupons originally attached thereto, including the value of the first fourteen coupons with accrued interest thereon, and in lieu thereof to receive a fully paid-up policy for $10,000—in other words, to apply his matured unpaid coupons with accrued interest thereon to convert his 19-payment life policy into a 14-payment life policy at the end of the fifteenth policy year. (See "Fully paid-up benefit", R. 12.) The "reserve" on a 19-payment life policy at the end of the fourteenth year (here the fifteenth policy year, since the first year is preliminary term insurance) is actually $377 per

[3] This statement may be verified by reference to the American Experience Table of Mortality, with interest at 3½%. See Willey, Principles and Practice of Life Insurance, Eighth Edition, p. 226.

thousand (R. 15). The aggregate value of the first fourteen coupons with accrued interest thereon is $153.78 per thousand, and the sum of the two, $530.78 per thousand. The net single premium at age 50 or the attained age at the end of the fifteenth policy year is but $508.49 per thousand.[4] Thus the actual cash or surrender value of the policy at the end of the fifteenth policy year plus the accumulated value of the fourteen matured and unsurrendered coupons with accrued interest thereon exceeds the net single premium on a $1,000 policy at age 50 by $22.29.

It has been contended that the presence of these coupons automatically converts the so-called 20-payment life policy from the date of issuance into a defeasible so-called 15-payment life policy. The provisions of the policy, however, negative this contention, since it is therein provided (R. 12) that upon the death of the insured before the actual conversion of the policy at the end of the fifteenth policy year the face of the policy plus the value of the matured coupons with accrued interest will be paid to the beneficiary. Obviously only the face of the policy would be payable if the conversion had actually occurred. Moreover, the table of cash or loan values attached to the policy (R. 15) shows that the reserve actually carried is that required on a 19-payment life policy.

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[4] See Willey, Principles and Practice of Life Insurance, Eighth Edition, p. 222.

From the foregoing examples it is apparent that the liability of the company is not increased beyond the face amount of the policy unless and until an option is exercised to purchase additional insurance or an annuity, in either of which events the holder of the coupons is in precisely the same situation as any other purchaser of insurance or of an annuity at age 55 who has available funds equal to the matured coupons with accrued interest. So also with respect to the option to reduce the premium-paying period. The liability of the company with respect to the face amount of the policy is not increased, and any individual with the requisite amount of cash would be permitted to convert a so-called 20-payment life policy into a so-called 15-payment life policy. The greatest possible liability of the insurer is no larger than it would be with respect to any person able and willing to devote the amount of cash represented by the coupons to an insurance contract.

It is unimportant, so far as the statutory intendment of reserve funds is concerned, that the excess payment of each year's premium over the amount required to carry the outstanding insurance is sufficient when added to what is already in reserve to purchase insurance on some other plan. Until the policyholder has exercised his option the amount held against the coupons represents no more than deposits at interest, and constitutes a pure liability. We submit that any

so-called reserve against such a liability is not an insurance reserve within the purview of the statute.

A further argument in support of our contention rests upon the very nature of the insurance reserve, which demonstrates that it can never apply to accrued liabilities due to individual policyholders in advance of their use for insurance purposes. The insurance reserve has reference to a large number of policyholders as a whole or group, and not to an individual policyholder. By the reserve funds set up the company is always in funds with which to meet an individual policy claim, irrespective of the time such individual policy may have been in force. To insure a single life within a given period is a gamble because the individual must either die or survive that period, with the result that there is either a great loss or gain. When a great number of lives are combined in the same group, the fluctuations in the rate of deaths from year to year will vary by only the smallest fraction of 1 per cent. Hence by means of the group, uncertainty of life is converted into certainty of death claims. Experience has shown that among a large group deaths will occur in accordance with a certain table of mortality. The "Experience Table" represents averages which can be relied upon. Therefore the "legal reserve" can never be based upon the company's account with an individual in which the group can never, directly or indirectly, par-

ticipate. Once a liability arises to an individual, as in the case of a policy loss claim, the amount ceases to be a part of the insurance reserve. It becomes a pure liability account with the individual.

The coupon credits here likewise are liabilities to individuals, having no reference to the group. To include them in the reserve for the group violates the basic principle upon which the insurance reserve is founded. If a sufficient number of persons is insured under all policies and at all different ages to insure the operation of the law of averages, the reserve so determined will be adequate for any policy. But there is nothing upon which the law of averages can operate until the matured coupon credits have been used to put life insurance in force. Until so used, they are merely accrued liabilities.

The language of the Court of Claims in *Continental Assur. Co.* v. *United States, supra,* is particularly apposite here. The court said in part (p. 482):

> The business, however, is based upon the law of averages for the group insured and for this reason the liability on the policy of life insurance prior to its maturity is not absolute but contingent. Therefore reserves, actuarily determined, must be set up out of premiums when paid to meet future unaccrued and contingent policy obligations at maturity. It was the "net value re-

serve,'" "something reserved from premiums to meet policy obligations at maturity" to which the Supreme Court referred in *New York Life Ins. Co.* v. *Edwards, supra,* and the Court held that the amounts there claimed were not reserves required by law within the meaning of the federal statutes because the liability of the company in that case was an accrued and absolute liability.

III

THE ADVERSE DECISIONS OF THE COURTS AND THE BOARD OF TAX APPEALS ARE BASED UPON MISCONCEPTIONS OF THE CHARACTER OF THE RESERVE REQUIRED BY LAW AND ITS RELATION TO THE AMOUNT IN ISSUE

The decision of the court below is based upon its prior decision in *Commissioner* v. *Great American Life Ins. Co.,* 70 F. (2d) 133, and it is necessary to look to the latter case to determine the basis of the court's holding that the amounts of matured unpaid coupons constitute reserves required by law within the meaning of the Act. In the *Great American Life Ins. Co.* case the court conceded that in using the word "reserve" Congress had in mind the technical insurance reserve, and that the company might not deduct a reserve which does not come within the technical meaning merely because it was required to be maintained by State authority. Its decision seems to be based upon the ground that the technical reserve is one held as against a contingent liability on outstanding policies; that the coupon liabilities meet the test since the time when they will be demanded in cash is de-

pendent upon the will of the insured, and also since they may later be converted into additional insurance benefits. From these facts the conclusion is drawn that the liability is contingent as to time and manner of payment.

The court has failed to note the real and important distinction between the technical reserve and the matured coupon liabilities. The technical reserve is based upon outstanding policies involving life risks, since it is only maintained in connection with all members of the group insured. The funds necessary to pay the face amount of the life policy in a particular case are not withdrawn solely from the premiums paid by the insured upon that policy, but from the aggregate funds contributed through premiums of the group. The contingent liability before maturity is accordingly general and not specific.

On the other hand, the funds necessary to pay the face amount of the matured coupons plus interest are made up solely from the excess premiums paid in by the individual, in which the other members of the group have no share, and with which the computation of the aggregate or group liability has no concern. Until the excess premiums represented by the coupons are converted into insurance involving the element of life risk, they are not properly a part of the group reserve. When and if they are so converted, they immediately become a part of the technical reserve upon which the deduction will be allowed. The fact that the time when the accrued

liability may be demanded is subject to the policyholder's will does not convert the individual liability into a group reserve.

The foregoing also illustrates the fact that the court was in error in likening the coupons to the cash surrender value of a policy. The amount of the obligation which the company will repay upon surrender of the policy is that portion of the group reserve which will be repaid and which is no longer necessary as a reserve if the existing life risk is cancelled. In order to obtain this amount it is necessary to surrender the policy and eliminate the face amount as a death benefit. But when the coupons are surrendered and cashed the face amount of the policy is not affected. It remains in existence as a life risk of the company for which a technical reserve must be maintained.

In holding that an accrued liability, the matured coupons, contingent as to time and method of payment, is embraced within the technical reserve, the court has, in effect, adopted that part of the definition used in *Maryland Casualty Co.* v. *United States, supra* (p. 350), which states that the reserve includes a fund set aside to liquidate "claims accrued, but contingent and indefinite as to amount or time of payment." As we have contended heretofore, that portion of this definition is contrary to the principles of *McCoach* v. *Insurance Co. of N. Amer., supra,* and was disapproved in *United States* v. *Boston Insurance Co., supra.*

It also appears that the court was greatly influenced by the statement made by this Court in *Williams* v. *Union Central Co.*, 291 U. S. 170, in which, speaking of guaranteed "premium reduction coupons" involved in the case of *Great Southern Life Ins. Co.* v. *Jones*, 35 F. (2d) 122 (C. C. A. 8th), this Court said (p. 182) that they were "fixed liabilities requiring a reserve." But neither case involved the question as to what constituted a *legal reserve* within the meaning of the taxing Acts. The sole point presented was whether an insurance company is bound to use any funds in its hands due the insured to avoid a forfeiture for nonpayment of premiums, the answer to which depends largely upon the provisions of the particular policy. We submit that the language used in the *Union Central* case gives no indication that this Court was concerned with a technical legal reserve, and that it cannot be considered authority for the proposition that accrued liabilities upon the coupons constitute a part of such reserve.

In *Commissioner* v. *Great American Life Ins. Co., supra*, the court also thought that the failure to amend the statute furnished strong evidence that the Board of Tax Appeals and the courts had correctly divined the legislative intent as to the meaning of "reserve funds required by law." But the fact that certain decisions have construed the deduction to include the amounts here involved does not demonstrate that this was the legislative intent. The Commissioner has not acquiesced in,

and has continued to oppose, this construction. The first of the decisions, that of the Board of Tax Appeals in *Standard Life Insurance Co. of America* v. *Commissioner, supra,* was promulgated in 1928. In 1926, after the decisions of this Court in *United States* v. *Boston Insurance Co., supra,* and *New York Ins. Co.* v. *Edwards, supra,* the Bureau issued a ruling specifically holding that coupons left with an insurance company and accrued interest thereon are not to be included in the reserves under Section 245 (a) (2) of the Revenue Act of 1921. S. R. 9610, V-2 Cumulative Bulletin 189. This has never been revoked, and it still represents the administrative position.

Finally, the necessity for maintaining reserves for matured coupons on the ground of solvency, stressed by the court in the *Great American Life Ins. Co.* case, *supra,* is beside the point. That such a requirement does not furnish the test for the legal reserve is answered by the language of this Court in *McCoach* v. *Insurance Co. of N. Amer., supra* (p. 589) that—

> The act of Congress, on the other hand, deals with reserves not particularly in their bearing upon the solvency of the company, but as they aid in determining what part of the gross income ought to be treated as net income for purposes of taxation.

Similarly, the fact that the company must set aside amounts from its investment income to meet the interest accruing on matured coupons is not

sufficient to justify the deduction as a reserve. For purposes of solvency it may likewise set aside from income amounts necessary to satisfy other accrued unpaid obligations. But this does not mean that the amounts necessary to meet such liabilities are part of the technical reserve contemplated by the statute.

The only other adverse decision in which any extended discussion of the principle occurred is that of the Board of Tax Appeals in *Standard Life Insurance Co. of America* v. *Commissioner, supra.* The decisions of the Circuit Court of Appeals for the Third Circuit in *Commissioner* v. *Standard Life Ins. Co. of America,* 47 F. (2d) 218, and the Circuit Court of Appeals for the Ninth Circuit in *Commissioner* v. *Western Union Life Ins. Co.,* 61 F. (2d) 207, are based upon that of the Board in the *Standard Life Insurance Co. of America* case. The only additional reasoning in the *Western Union Life Ins. Co.* case is based upon the assumption that the coupon liabilities come within that part of the definition of a reserve contained in the *Maryland Casualty Co.* case (p. 350), but subsequently disapproved in *United States* v. *Boston Insurance Co., supra,* namely, "claims accrued, but contingent and indefinite as to amount or time of payment."

The Board's decision in the *Standard Life Insurance Co. of America* case is based upon certain assumptions which we contend are erroneous. The Board stated that the definition of reserves in the

McCoach case as funds held against the contingent liability on outstanding policies does not apply to life-insurance companies, since the life-insurance company has an absolute and uncontingent liability in respect of every policy; that the liability upon unsurrendered coupons is likewise absolute and the same as the liability to pay any portion of the principal of the policy; that if the company pays the face amount of the coupons it is simply paying a policy obligation and the insured has surrendered part of the policy; consequently, a reserve to meet the coupons is something reserved from premiums to meet policy obligations at maturity, within the language used by this Court in *New York Ins. Co.* v. *Edwards, supra,* p. 119.

The fundamental error in the Board's reasoning lies in the assumption that a life-insurance company has an absolute liability in respect of every policy so long as premiums are paid thereon, and that such liability is not contingent. We have already pointed out that it is only upon the maturity of a policy that a policyholder becomes a creditor of the company; then, for the first time, there is an indebtedness (*Duffy* v. *Mutual Benefit Co., supra,* p. 618). If the life insurance company's liability is contingent and not absolute on its life contracts, then reserves are required. If the company's liability were absolute to the individual policyholder, as the Board decides, there would be no need for the use of mortality tables. Since the business of life insurance is based upon the law of

averages for the group insured, the liability on a policy of life insurance prior to its maturity is not absolute but contingent. Accordingly, reserves actuarily determined must be set up out of premiums when paid to meet future unaccrued and contingent policy obligations at maturity. It was the net value reserve, "something reserved from premiums to meet policy obligations at maturity", to which this Court referred in the *New York Ins. Co.* case, *supra,* and it was because the liability of the company in that case for death losses, which had occurred but were unreported, was an accrued and absolute liability that the amounts there claimed as reserves were held not to constitute "reserves" required by law within the meaning of the Federal statutes.

Another erroneous premise of the Board is that the company is simply paying off a policy obligation and that the policyholder has surrendered a part of his policy when a matured coupon is paid with interest. Clearly the policyholder, by demanding and accepting the amount due him on his matured coupons with interest, does not surrender any part of his life-insurance policy, nor is the company's net value reserve held against its life-insurance obligations at maturity thereby affected in the slightest degree. The fact is that the company by the payment of a matured coupon with interest discharges to that extent a pure liability which had accrued on the coupon contract, and which had never represented life insurance in

force. It still remains bound to the insured to the fullest extent of its life-insurance policy obligation, against which it was required to maintain the legal reserve.

In subsequent decisions the Board has held that dividends of a mutual company left with the company are not reserves required by law. See *Midland Mutual Life Insurance Co.* v. *Commissioner,* 19 B. T. A. 765. The Court of Claims has held to the same effect. *Minnesota Mutual Life Ins. Co.* v. *United States,* 66 C. Cls. 481, certiorari denied, 279 U. S. 856; *Massachusetts Mut. Life Ins. Co.* v. *United States,* 56 F.(2d) 897. It has also been held that the interest upon such dividends, when paid, is deductible as interest under Section 245 (a) (8) of the Revenue Act of 1926 (c. 27, 44 Stat. 9, U. S. C. App., Title 26, Sec. 1004), just as the interest was allowed in this case. See *Massachusetts Mut. Life Ins. Co.* v. *United States,* 59 F.(2d) 116 (C. Cls.), affirmed by this Court, 288 U. S. 269. There is no real distinction in principle, insofar as the reserve question is concerned, between such a dividend and a coupon of the type here involved. Each becomes an accrued liability, the dividend upon its declaration, the coupon upon its maturity and the payment of the requisite premium. Thenceforth each is an accrued liability of the company, and not a life risk requiring the insurance reserve, unless and until it is converted into some form of insurance at life risk requiring a group reserve. We contend that the decisions

in the cases just cited represent the correct view and that the same principle should apply to matured coupon liabilities.

We submit that the conclusions of the Court of Claims recited in its opinion in *Continental Assur. Co.* v. *United States,* 8 F. Supp. 474, 483–484, are correct and dispose of the controversy here, namely:

> (1) That accrued liabilities are not the subject of the "reserve fund" deductions granted by Congress in any of the revenue acts; (2) that the "reserve" contemplated in the Federal statutes is "that fund which when added to the present value of future net premiums is equal to the present value of future death claims"; that is, the mathematical equivalent of the obligation incurred by the company to pay the sum insured at the death of the policyholder or upon the surrender and cancellation of the policy; (3) that the "reserve" contemplated in the federal statutes is calculated upon the basis of a selected table of mortality plus an assumed rate of interest; and that reserves not so calculated, whether required by state law or by state officer, are not "reserve funds required by law" within the meaning of the federal statutes; and (4) that the "reserve fund" required by law within the meaning of the federal statutes does not include "solvency" reserves required to be maintained by state law or a state officer to keep the company in sound financial condition.

CONCLUSION

It is respectfully submitted that the decision of the court below is erroneous and should be reversed.

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APPENDIX

Revenue Act of 1921, c. 136, 42 Stat. 227, 261:

SEC. 245. (a) That in the case of a life-insurance company the term "net income" means the gross income less—

* * * * *

(2) An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life-insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

* * * * *

(8) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title;

* * * * *

Treasury Regulations 62, promulgated under the Revenue Act of 1921:

> ART. 681. *Reserve funds.*—Under paragraphs (1) and (2) of section 245 (a), life insurance companies are entitled to deduct from gross income: (1) Interest which is exempted in the case of other taxpayers by section 213 (b) (4) and articles 74–83; and (2) the excess, if any, of the reserve deduction specified in section 245 (a) (2) over the amount of such interest. The reserve deduction is based upon the reserves required by express statutory provisions or by the rules and regulations of the State insurance departments when promulgated in the exercise of a power conferred by statute; but such reserves do not include assets required to be held for the ordinary running expenses of the business nor do they include the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance. In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserves thereon be based upon recognized tables of experience covering disability benefits of the kind contained in policies issued by this particular class of companies. Only reserves peculiar to insurance companies are to be taken into consideration. Reserves "maintained to provide for the ordinary running expenses of a business, definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance and unpaid brokerage" (*Maryland Casualty Co.* v. *United States,* 251 U. S. 342),

will not be considered. A company is permitted to make use of the highest aggregate reserve called for by any State in which it transacts business, but the reserve must have been actually held as shown by the annual statement. Generally speaking, the following will be considered reserves as contemplated by the law: Items 7, 8, 9, 10, and 11 of the liability page of the annual statement for life companies, and items 16, 17, 18, 19, and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business. If other reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the State statute or insurance department ruling requiring that such reserves be held.

Revised Statutes of Utah, 1933, Title 43:

CHAPTER 3

* * * * *

SEC. 4. *Capital to be full-paid and unimpaired.*—No stock company shall do any [life] insurance business in this state before its capital is fully paid up. Said capital must be unimpaired, that is, the assets of such company must equal or exceed all liabilities for losses reported, expenses, taxes and other outstanding *liabilities,* including *the legal reserves* as provided in sections 43–3–12 * * * (L. 21, p. 96, § 1144 [8]). (Italics supplied.)

* * * * *

SEC. 12. *Life insurance—Valuation of policies and reserves.*—For the purpose of making valuations of life insurance policies and of determining the reserves required to be maintained therefor under the provisions of this title *the rate of interest assumed* shall be 3½ percent per annum, and the rate of mortality shall be established by the table known as the "American Experience Table of Mortality" for policies issued after January 1, 1910; * * * (C. L. 17, § 1153). (Italics supplied.)

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